DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 00-0253
Financial Institutions Tax
For the Tax Years 1993 through 1996

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ISSUES

I. Applicability of the Financial Institutions Tax.

Authority: IC 6-5.5 et seq.; IC 6-8.1-5-1(b); 45 IAC 17-2-1(a); 45 IAC 17-2-3; 45 IAC 17-3-5; 45 IAC 17-3-5(a); 45 IAC 17-3-5(c); 45 IAC 17-3-5(d).

Taxpayer argues that the audit erred in determining that taxpayer was subject to the state's Financial Institutions Tax (FIT). Taxpayer maintains that its only business contact with the state was through the leasing of business equipment.

II. Statute of Limitations – Financial Institutions Tax.

Authority: IC 6-5.5-6-1; IC 6-8.1-1-1; IC 6-8.1-5-2(a); IC 6-8.1-5-2(e); 45 IAC 15-5-7(f); 45 IAC 17-3-5(a); Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304 (1940)

Taxpayer argues that the FIT assessment, for the tax years 1993 through 1995, is untimely. According to taxpayer, its otherwise timely filing of the Indiana Corporation Income Tax Return (IT-20), started the three-year limitations period during which the state was obligated to propose any additional taxes.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that assessment of the ten-percent negligence penalty was unwarranted because, at all relevant times, taxpayer exercised good business judgment in determining its Indiana tax liability.

STATEMENT OF FACTS

Taxpayer is an out-of-state institution which, as stated by taxpayer, "was engaged in the business of a bank holding company . . . subject to regulation by the Federal Reserve Board." During the years at issue, taxpayer owned two out-of-state banking corporations along with an out-of-state subsidiary engaged in the activity of leasing business equipment. For the years at issue, the subsidiary leasing company filed Indiana Corporate Income Tax Returns (IT-20) on a "separate company basis."

The Department of Revenue conducted an audit of taxpayer's records and determined that taxpayer, together with its related business entities, was liable under the state's Financial Institutions Tax scheme because taxpayer's various subsidiaries conducted the business of a financial institution within the state. The audit determined taxpayer's FIT liability on the ground that taxpayer, along with its affiliates, should originally have filed a combined FIT return. Taxpayer disagreed with the audit's conclusions, submitted a protest, and an administrative hearing was conducted. This Letter of Findings follows as a result of the protest and subsequent hearing.

DISCUSSION

I. Applicability of the Financial Institutions Tax.

Taxpayer maintains that the audit erred when it concluded that it should have been reporting its income on a combined FIT return. The fact that taxpayer is conducting business within the state is uncontested. Taxpayer does challenge the audit's conclusion that it should have been submitting a "combined return" for its "unitary group."

Indiana imposes a franchise tax, known as the Financial Institution Tax (FIT), on corporations transacting the business of a financial institution inside the state. IC 6-5.5 et seq. The tax is imposed on resident financial institutions, nonresident financial institutions, and on non-bank entities that transact the business of a financial institution. 45 IAC 17-2-1(a). The term "Financial Institution" is defined at 45 IAC 17-2-3 which states as follows:

> The "business of a financial institution" means the activities of a holding company, a regulated financial corporation, or a subsidiary of either that each is authorized to perform under federal or state law, including the activities authorized by regulation or order of the Federal Reserve Board for such a subsidiary under Section (4)(C)(8) of the Bank Holding Act of 1956 (12 U.S.C. 1843(C)(8)).

One of taxpayer's own subsidiary's leased tangible personal property – apparently the office equipment referred to in its protest – to customers within the state. Another one of taxpayer's own subsidiaries had business within the state during 1996; that business consisted of processing unsecured consumer loans. Taxpayer, itself, is a bank holding company as defined under the Bank Holding Company Act of 1956, 12 U.S.C.S. § 1843(c)(8). The audit concluded that taxpayer "[had] no types of corporations exempt from the financial institutions tax . . . ."

45 IAC 17-3-5 requires that members of a "Unitary Group" file a single, combined return for the purposes of determining the group's FIT liability. That regulation states, in relevant part, as follows:

> A "unitary business" means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually, or as a group, in transacting the business of a financial institution. Unity of ownership exists when a corporation is a member of a group of two (2) or more entities and more than fifty percent (50%) of the voting stock of each member of the group is directly or indirectly owned by: (1) a common owner or common owners, either corporate or noncorporate . . . . 45 IAC 17-3-5(c).

The regulation further requires that "A unitary group for purposes of the FIT is composed of those taxpayer members that are engaged in a unitary business transacted wholly or partially within Indiana." Id. Once it has been determined that a unitary group is conducting the business of a financial institution, "A designated taxpayer who is a member of a unitary group shall file a combined return covering all the operations of the unitary business and including all taxpayer members of the unitary group." 45 IAC 17-3-5(a). "Therefore, if one (1) one member of a unitary group is conducting the business of a financial institution in Indiana, then all members of the unitary group engaged in a unitary business must file a combined return, even if some of the members are not transacting business in Indiana." 45 IAC 17-3-5(d).

Taxpayer has failed to provide information sufficient to overcome the presumption of correctness afforded the audit's conclusions under IC 6-8.1-5-1(b). Taxpayer falls within the definition of a "bank holding group." Together with its various subsidiaries, taxpayer constitutes a "unitary group," is conducting the "business of a financial institution," and is conducting that business "wholly or partially within Indiana." Accordingly, the audit did not err in concluding that taxpayer came within the purview of the state's Financial Institutions Tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Statute of Limitations – Financial Institutions Tax.

Taxpayer argues that the assessment of taxes for the years 1993 through 1995 was untimely because the statute of limitations period had expired. The audit disagreed on the ground that taxpayer's filing of the Indiana Corporation Income Tax Returns (IT-20) was erroneous and that the limitations period did not begin at the time the IT-20 returns were originally submitted.

The limitations period is defined under IC 6-8.1-5-2(a) which states that, "Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed . . . ." IC 6-8.1-5-2(e) defines certain circumstances under which three-year limitations is tolled. "If a person files a fraudulent, unsigned, or substantially blank return, of if a person does not file a return, there is no time limit within which the department must issue its proposed assessment."

There is no contention that taxpayer's IT-20 returns were "fraudulent," that the IT-20 returns were "unsigned," or that the forms were "substantially blank." Therefore – according to taxpayer

– because it filed "*a* return" for each of the years at issue, the three-year limitations has elapsed for three of the tax years for which it was assessed additional taxes.

Taxpayer cites to Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304 (1940) in support of its contention, that the filing of the IT-20 returns started the three-year limitations period. In Germantown Trust, the Court held that the two-year limitations period under Rev. Act. 1932, § 275(a), precluded the Internal Revenue Service from making a deficiency assessment against the petitioner. On behalf of its trust patrons, the petitioner had originally filed a "fiduciary return" but failed to file a corporate return reporting the petitioner's own income. Four years later, the IRS prepared a substitute corporate return and gave notice of the petitioner's tax deficiency. The IRS argued that the filing of the fiduciary return was the equivalent to "no return of the tax" under Rev. Act. 1932, § 275(c) which provided an extended four-year limitations period. The Court rejected the government's contention and agreed with the petitioner because petitioner's fiduciary return "contained all of the data from which a tax could be computed and assessed [even though] it did not purport to state any amount due as tax." Id at 307.

Despite the superficial similarities, the circumstances in Germantown Trust and the taxpayer's protest are significantly different. Taxpayer filed IT-20 returns, a decision which the Department determined was entirely erroneous; in Germantown Trust, the petitioner submitted a fiduciary return which, as the Court stated, the petitioner was "bound to file." Id. at 308. In Germantown Trust, the trust return "contained all the data from a tax could be computed and assessed." Id. In contrast, taxpayer may not contend that the IT-20 forms, filed on behalf of a single entity, was sufficient to determine the FIT liability for the entire unitary group. Finally, the Court in Germantown Trust was interpreting the specific provisions contained within Rev. Act. 1932, § 275(a), (c). Taxpayer's own protest is resolved by application of IC 6-8.1-5-2 and the regulations which interpret the statutory requirements.

Those regulations include 45 IAC 15-5-7(f) which states that, "The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision." The term "listed tax" is defined at IC 6-8.1-1-1 which specifically includes "financial institutions tax" as one of the state's "listed taxes." Under that portion of the Indiana Code outlining a taxpayer's responsibilities under the Financial Institutions Tax, IC 6-5.5-6-1 states that "[a]nnual returns with respect to the tax imposed by this article *shall* be made by every taxpayer: (1) having for the taxable year adjusted gross income or apportioned income subject to taxation under this article . . . ." (*Emphasis added*). The filing requirement is repeated at 45 IAC 17-3-5(a) which states, "A designated taxpayer who is a member of a unitary group *shall* file a combined return covering all the operations of the unitary business and including all taxpayer member of the unitary group." (*Emphasis added*). Therefore, because taxpayer did not file the required FIT returns and because the FIT is one of the state's "listed taxes," the three-year limitations period does not preclude the current assessment for unpaid taxes. Even assuming the taxpayer's good efforts in submitting the IT-20 forms for the years in question, the limitations period did not begin to run at the time those forms were first submitted.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer protests the assessment of the ten-percent negligence penalty against the amount of tax deficiency determined at the time of the original audit.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Taxpayer is a substantial and sophisticated business entity fully capable of determining – with a reasonable degree of accuracy – its Indiana tax liabilities. It has failed to demonstrate that it exercised the degree of "ordinary business care" necessary for the Department to abate the penalty.

FINDING

Taxpayer's protest is respectfully denied.

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